

March 7, 2003

Honorable William Lyons, Jr.  
Secretary of Agriculture  
California Department of Food and Agriculture  
1220 N Street  
Sacramento, California 95814

Dear Secretary Lyons:

Land O' Lakes petitions the Department to hold a hearing on transportation credits and allowances. The reasons for the petition are explained in the next paragraph. We are petitioning to hold a hearing on both transportation credits and allowances, which would require a hearing both in milk pooling and in milk stabilization. We hope that serious consideration will be given to these proposals.

There have been significant changes in the structure of the dairy industry in California in the last couple of years. From a firm standpoint, the processing industry has become significantly more concentrated. But, one factor has not changed and that is that significant amounts of milk are moved from the South Valley into Southern California. California sources of milk need to be more competitive with out-of-state sources of milk. In order to facilitate servicing the Class 1 market it is our position that it is necessary to not only adjust the transportation credit from the South Valley to Southern California but to add a separate higher transportation credit into Riverside County. Land O' Lakes has serviced Southern California for more than 50 years and we have serviced an account in Riverside County for many years. Our proposal is to adjust the transportation credit from the South Valley to Southern California, to expand the transportation allowances from the South Valley to Southern California and to amend the transportation allowances for milk in San Bernardino and Imperial County in Southern California.

Fuel costs have been increasing at an enormous rate. The hauling rates have been adjusted and it looks as if there could be further adjustments at the end of this month. Therefore, we are making the following proposal with no shortfall—only because further price increases are immanent.

Proposal number 1: Adjust the transportation credit from 50 cents to 76 cents for milk shipped from Tulare County to Riverside County and to San Diego from 50 cents to 68 cents for milk shipped from Tulare County to LA county, Orange County or Ventura Counties. The hauling cost from Tulare to LA County, Orange or Ventura Counties is 95 cents per cwt. The math is as follows: The current area differential is 27 cents per cwt and so the difference between 95 cents and 27 cents is 68 cents. The hauling cost from Tulare to Riverside County is \$1.03. The difference between  $\$1.03 - .27 = \$.76$  per cwt. There has usually been a shortfall in moving milk on a plant-to-plant basis from the South Valley to Southern California. Our proposal is that we remove the shortfall only because rates are going to continue to increase as fuel prices continue to go up. Today, the shortfall from Tulare to Riverside County is 26 cents and LA and Orange Counties it

is 18 cents and that is the largest shortfall in history for moving milk on a plant-to-plant basis from the South Valley to Southern California. We, of course, recommend that the area differential be maintained at 27 cents per cwt between Northern and Southern California.

In addition, we are requesting that the transportation credit apply to condensed skim as well. The difference in the Class 2 price between Northern California and Southern California amounts to \$.8256 per cwt for condensed skim assuming a solids percentage of 32 percent. The hauling cost from Tulare to LA county customers is \$.95 per cwt, which means there is a shortfall of  $(.95 - .8256)$  of \$.1244. Without a shortfall, we are recommending a transportation credit of \$.1244 for condensed skim from Tulare to LA and Orange County plants. The hauling cost from Tulare to Riverside County is \$1.03, which means there is a shortfall of  $(1.03 - .8256)$  of \$.2044. Again, without a shortfall, we are recommending a transportation credit of \$.2044 for condensed skim from Tulare to Riverside County.

The specific language would be as follows:

Section 300.2. Each handler located in counties designated herein as a supply county may deduct from the applicable minimum prices pursuant to Section 300.00, paragraph (A), a transportation credit for quantities of market milk and market skim milk shipped in bulk form to a plant located in a designated county. Shipments of cream are excluded from such transportation credits. Such deduction shall not exceed amounts shown for such bulk transfers in the following schedule:

Maximum Deduction	For Shipments to
Per cwt	Designated Deficit Counties
Tulare County	<b>Riverside</b>
Tulare County	Orange, Los Angeles or Ventura Counties
Fresno County	<b>Riverside</b>
Fresno County	Orange, Los

Angeles or  
Ventura  
Counties

The schedule for condensed skim would be as follows:

<b>Tulare County</b>	<b>\$2044</b>	<b>Riverside</b>
<b>Tulare County</b>	<b>\$1244</b>	<b>Orange, Los Angeles or Ventura Counties</b>

The remainder of the transportation credits would remain unchanged.

Proposal 2. To make California more competitive with out-of-state sources and to provide more producer equity, we are recommending three important changes in the transportation allowance. One is to expand the transportation allowance to Riverside County, the second is to adjust the current transportation allowance in San Bernardino County to reflect the difference between the cost of the milk haul to a manufacturing facility and to the Class 1 market and third as in earlier versions of the transportation allowance, we are recommending that the supply counties be limited. We recommend the elimination of Fresno County as a supply county for the transportation allowance system. As usual we believe the transportation allowance should be available only to producers who have the option of shipping their milk to a manufacturing facility.

Section 921. Producers, including producer-members of cooperative associations, will receive transportation allowances on shipments to plants which are located within designated areas and which, during the immediately preceding 12-month period actually processed more than 50 percent of the total pounds of milk processed at the plant location into products other than Class 4a or Class 4b. For purposes of this section, a "plant" includes one of more pool plants under single ownership within a designated area.

For plants located in the Southern California receiving area which shall consist of the counties of Los Angeles, Orange, Ventura and Riverside:

(1) From Inyo, Los Angeles, Mono, Orange, Riverside, San Bernardino, and Ventura counties the following transportation allowance will apply:

From zero through 89 miles	0
Over 89 miles	\$ .12 per Cwt

(2) From Santa Barbara, San Diego, Imperial, Kern, Kings and Tulare Counties

From zero through 89 miles	0
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Over 89 through 139 miles  
Over 139 miles

\$.43 per CWT  
\$.58 per CWT

For plants located in the San Diego receiving area, which consist of the County of San Diego:

**(1) From Inyo, Los Angeles, Mono, Orange, Riverside, San Bernardino, and Ventura counties:**

From zero through 89 miles  
Over 89 miles

0  
\$.12 per Cwt

**(2) From Santa Barbara, San Diego, Imperial, Kern, Kings and Tulare Counties**

From zero through 89 miles  
Over 89 miles through 139 miles  
Over 139 miles

0  
\$.43 per Cwt  
\$.58 per Cwt

Justification for the proposals:

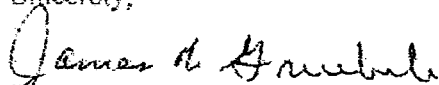
1. One of the reasons for the adjustments in the transportation credits is to provide equity among Class 1 milk supplying firms from the surplus producing areas into the deficit market areas in Southern California. There are certainly adequate amounts of milk available to meet the Class 1 needs in this state. These adjustments will help to make California sources to be more competitive for Class 1 markets in California. A second reason is producer equity. A producer should not incur higher costs to move milk to a Class 1 plant than to a local manufacturing facility.
2. There is a need for more than a single transportation credit makes because it is much easier to achieve equal raw product costs among firms if the transportation credit is applied in two locations. It simply costs more to move milk from the South Valley into Riverside County than it does from the South Valley into Los Angeles, Orange or Ventura Counties.
3. The use of more than one transportation credit is in accord with what is being done in Federal order markets. The Federal order markets that use the transportation credit use the mileage from the supply plant to the Class 1 plant wherever it is located. That concept has logic. In fact, we are recommending one transportation credit from Tulare to Riverside County and another transportation credit from Tulare to Los Angeles, Orange and Ventura Counties.

4. One of the advantages of moving milk on a plant-to-plant basis from the South Valley is that the milk can be tailored to match the utilization of fat and solids not fat in milk used for Class 1 purposes. In fact, most of the milk moved to Southern California from the South Valley on a plant-to-plant basis has been tailored milk. The tailoring of milk avoids the costly process of separating the milk into skim and into cream in the Southern California bottling plant and from shipping surplus cream from Southern California to the South Valley for processing such cream into butter.
5. Economic theory supports the concept that price differences in milk reflect costs of transportation when moving milk from surplus to deficit markets. In California such costs of transportation are compensated for through the use of transportation allowances and credits.
6. From a historic standpoint, California has always had an area differential or a combination of an area differential and a transportation credit to reflect the cost of moving milk from surplus producing areas to deficit markets. The same is true in Federal order markets.
7. Land O' Lakes has served customers in Southern California for 50 years or more. Land O' Lakes has been meeting its commitment to serve the Class 1 market and they have done that for years.
8. The transportation allowances should be adjusted to reflect the additional cost for serving Class 1 markets than local manufacturing facilities in San Bernardino and Imperial County. The current transportation allowances for San Bernardino and Imperial Counties are larger than should be the case.
9. The expansion of the transportation allowance into Riverside County also makes sense. Milk is being moved into Riverside County from the South Valley and it makes sense to allow producer milk to move on a ranch to plant basis from the South Valley into Riverside County. The expansion of the transportation allowance from the South Valley into Riverside County also makes California sources of milk more competitive with milk from other sources.
10. At one time the difference between the cwt value of condensed between Northern and Southern California covered the freight cost for moving that product from Tulare to Southern California. This is no longer the case. Freight costs have continued to increase and so we find it necessary to recommend the addition of a transportation credit for condensed skim. Furthermore, the shipment of condensed from the "South Valley" saves hauling cream back from the Southern California area. If the supplying firm paid the freight, our analysis shows that it is actually advantageous for a Southern California Class 1 plant to buy out-of-state

condensed skim rather than from in-state South Valley sources provided the California Class 1 processor pays less than the modified quota price.

We urge that the Department call a hearing on these important issues. Thank you.

Sincerely,



James W. Gruebele  
Consultant for Land O' Lakes

CC: Kelly Krug  
David Ikari  
John Lee